

Office of the State Auditor

Division of State Audit

North Dakota Veterans' Home Lisbon, North Dakota

Audit Report for the
Biennium Ended June 30, 2007
Client Code 31300

Robert R. Peterson
State Auditor



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Transmittal Letter

July 22, 2008

The Honorable John Hoeven, Governor
Members of the North Dakota Legislative Assembly
Mark Johnson, Administrator

We are pleased to submit this audit of the North Dakota Veterans' Home for the biennium ended June 30, 2007. This audit resulted from the statutory responsibility of the State Auditor to audit or review each state agency once every two years. The same statute gives the State Auditor the responsibility to determine the contents of these audits.

In determining the contents of the audits of state agencies, the primary consideration was to determine how we could best serve the citizens of the state of North Dakota. Naturally we determined financial accountability should play an important part of these audits. Additionally, operational accountability is addressed whenever possible to increase efficiency and effectiveness of state government.

The in-charge auditor for this audit was David Feltman. Robyn Hoffmann, CPA and Mary Feltman, CPA were the staff. John Grettum, CPA was the audit manager. Inquiries or comments relating to this audit may be directed to the audit manager by calling (701) 239-7289. We wish to express our appreciation to Administrator Johnson and his staff for the courtesy, cooperation, and assistance they provided to us during this audit.

Respectfully submitted,

Robert R. Peterson
State Auditor

Executive Summary

INTRODUCTION

The North Dakota Veterans' Home (Home) is a state sponsored institution whose general supervision and government is vested in the Administrative Committee on Veterans' Affairs (Committee) as noted in Chapter 37-18.1 of the North Dakota Century Code. The chairman and secretary of the Committee, acting jointly, shall appoint a seven member governing board for the administration of the Home, from within or outside the Committee, subject to ratification by a majority of the Committee. The Home is located on a 90-acre tract of land adjacent to the city of Lisbon and has been in operation since 1893.

More information about the Home can be obtained from their home page at: www.nd.gov/ndvh/.

RESPONSES TO LAFRC AUDIT QUESTIONS

The Legislative Audit and Fiscal Review Committee (LAFRC) requests that certain items be addressed by auditors performing audits of state agencies.

1. What type of opinion was issued on the financial statements?

Financial statements were not prepared by the North Dakota Veterans' Home in accordance with generally accepted accounting principles so an opinion is not applicable. The agency's transactions were tested and included in the state's basic financial statements on which an unqualified opinion was issued.

2. Was there compliance with statutes, laws, rules, and regulations under which the agency was created and is functioning?

Other than our findings addressing "administrator salary increase" (page 16) and "procurement" (page 17), the North Dakota Veterans' Home was in compliance with significant statutes, laws, rules, and regulations under which it was created and is functioning.

3. Was internal control adequate and functioning effectively?

Other than our findings addressing "computer processing controls weakness" (page 11), "accounts receivable subsidiary" (page 12) and "purchasing card support" (page 13), we determined internal control was adequate.

4. Were there any indications of lack of efficiency in financial operations and management of the agency?

No.

5. *Has action been taken on findings and recommendations included in prior audit reports?*

The North Dakota Veterans' Home has implemented all recommendations included in the prior audit report.

6. *Was a management letter issued? If so, provide a summary below, including any recommendations and the management responses.*

Yes, a management letter was issued and is included on page 18 of this report, along with management's response.

LAFRC AUDIT COMMUNICATIONS

1. *Identify any significant changes in accounting policies, any management conflicts of interest, any contingent liabilities, or any significant unusual transactions.*

There were no significant changes in accounting policies, no management conflicts of interest were noted, no contingent liabilities were identified or significant unusual transactions.

2. *Identify any significant accounting estimates, the process used by management to formulate the accounting estimates, and the basis for the auditor's conclusions regarding the reasonableness of those estimates.*

The most significant accounting estimate used by the North Dakota Veterans' Home relates to the useful lives of capital assets. Estimated useful lives are used to compute depreciation on capital assets. We compared depreciation to prior years and agreed current audit depreciation to supporting schedules.

3. *Identify any significant audit adjustments.*

Significant audit adjustments were not necessary.

4. *Identify any disagreements with management, whether or not resolved to the auditor's satisfaction relating to a financial accounting, reporting, or auditing matter that could be significant to the financial statements.*

None.

5. *Identify any serious difficulties encountered in performing the audit.*

None.

6. *Identify any major issues discussed with management prior to retention.*

This is not applicable for audits conducted by the Office of the State Auditor.

7. *Identify any management consultations with other accountants about auditing and accounting matters.*

None.

8. *Identify any high-risk information technology systems critical to operations based on the auditor's overall assessment of the importance of the system to the agency and its mission, or whether any exceptions identified in the six audit report questions to be addressed by the auditors are directly related to the operations of an information technology system.*

ConnectND Finance, Human Resource Management System (HRMS), and MDI Technologies are high-risk information technology systems critical to the North Dakota Veterans' Home. The finding regarding "computer processing controls weakness" directly relates to the MDI Technologies system.

Audit Objectives, Scope, And Methodology

Audit Objectives

The objectives of this audit of the North Dakota Veterans' Home for the biennium ended June 30, 2007 were to provide reliable, audited financial statements and to answer the following questions:

1. What are the highest risk areas of the North Dakota Veterans' Home's operations and is internal control adequate in these areas?
2. What are the significant and high-risk areas of legislative intent applicable to the North Dakota Veterans' Home and are they in compliance with these laws?
3. Are there areas of the North Dakota Veterans' Home's operations where we can help to improve efficiency or effectiveness?

Audit Scope

This audit of the North Dakota Veterans' Home is for the biennium ended June 30, 2007. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The North Dakota Veterans' Home sole location is at Lisbon, North Dakota, which will be included in the audit scope.

Audit Methodology

To meet the objectives outlined above, we:

- Prepared financial statements from the legal balances on the state's accounting system tested as part of this audit and the audit of the state's Comprehensive Annual Financial Report and developed a discussion and analysis of the financial statements.
- Performed detailed analytical procedures including computer assisted auditing techniques. These procedures were used to identify high risk transactions and potential problem areas for additional testing.
- Tested internal control and compliance with laws and regulations which included selecting representative samples to determine if controls were operating effectively and to determine if laws were being followed consistently. Nonstatistical sampling was used and the results were

projected to the population. Further where applicable, populations were stratified to ensure that particular groups within a population were adequately represented in the sample, and to improve efficiency by gaining greater control on the composition of the sample.

- Interviewed appropriate agency personnel.
- Queried the ConnectND (PeopleSoft) ERP system. Given the complexity of the state's accounting system significant evidence was obtained from ConnectND.
- Observed North Dakota Veterans' Home's processes and procedures.

In aggregate there were not any significant limitations or uncertainties related to our overall assessment of the sufficiency and appropriateness of audit evidence.

Confidential or Sensitive
Information Omitted

No confidential or sensitive information was omitted.

Discussion And Analysis

The accompanying financial statements have been prepared to present the North Dakota Veterans' Home's revenues and expenditures on the legal (budget) basis. The accompanying financial statements are not intended to be presented in accordance with generally accepted accounting principles (GAAP).

For the biennium ended June 30, 2007, operations of the North Dakota Veterans' Home were primarily supported by appropriations from the state's general fund as well as the revenues discussed below.

FINANCIAL SUMMARY

Revenues consisted primarily of charges for services, which are reported as health revenue; federal funds, which are reported as intergovernmental revenue; and monies from the State Land Department, which are reported as transfers in. These all remained fairly constant for the North Dakota Veterans' Home, increasing only slightly. Total revenues were \$4,375,407 for the year ended June 30, 2007 as compared to \$3,919,137 for the year ended June 30, 2006.

Total expenditures for the North Dakota Veterans' Home were \$6,021,485 for the year ended June 30, 2007 as compared to \$5,638,566 for the prior year. All expenditures remained fairly constant.

Total custodial and resident trust funds balances were \$216,813 and \$138,830 as of June 30, 2007 and June 30, 2006, respectively.

ANALYSIS OF SIGNIFICANT CHANGES IN OPERATIONS

There were no significant changes in operations.

ANALYSIS OF SIGNIFICANT VARIANCES BETWEEN FINAL BUDGETED AND ACTUAL EXPENDITURES

There were no significant variances between final budgeted and actual expenditures.

Financial Statements

STATEMENT OF REVENUES AND EXPENDITURES

<u>Revenues and Other Sources:</u>	<u>June 30, 2007</u>	<u>June 30, 2006</u>
Health	\$ 2,599,440	\$ 2,214,273
Intergovernmental Grants/Contracts	1,555,021	1,480,528
Charges for Services/Sales	72,920	81,109
General Government	6,125	2,210
Leases, Rents, and Royalties	3,084	2,856
Interest and Investment Earnings	2,932	2,161
Contributions and Private Grants	900	957
Miscellaneous General Revenue	185	243
Transfers In	134,800	134,800
Total Revenues and Other Sources	\$ 4,375,407	\$ 3,919,137
<u>Expenses and Other Uses:</u>		
Salaries and Benefits	\$ 3,889,376	\$ 3,798,187
Medical, Dental, and Optical	469,878	477,882
Food and Clothing	322,105	257,537
Fees - Professional Services	279,537	197,505
Utilities	277,997	217,032
Other Capital Payments	115,035	116,476
Building, Grounds, Vehicle Supply	95,590	90,026
Travel	88,675	70,138
Extraordinary Repairs	79,796	10,714
Equipment Over \$5000	49,991	30,785
IT - Communications	45,451	48,438
IT - Data Processing	39,708	36,963
Supply/Material-Professional	39,146	41,484
Professional Development	38,339	28,001
Insurance	37,526	11,817
Repairs	34,596	49,009
Miscellaneous Supplies	33,574	31,057
Office Supplies	26,953	21,960
Operating Fees and Services	13,054	12,741
IT Contractual Services and Repairs	11,274	18,547
Other Equipment under \$5,000	8,222	24,649
Supplies - IT Software	6,541	3,113
Rentals/Leases-Equipment and Other	4,259	3,353
Office Equipment and Furniture-Under \$5,000	4,005	2,553
Printing	3,923	2,242
Postage	2,838	4,300
Rentals/Leases - Building/Land	2,034	1,869
IT Equip under \$5,000	1,523	20,653
Land and Buildings	539	2,681
IT Equipment Over \$5000		6,854
Total Expenses and Other Uses	\$ 6,021,485	\$ 5,638,566

STATEMENT OF APPROPRIATIONS

For The Biennium Ended June 30, 2007

Expenditures by Line Item:	Original Appropriation	Adjustments	Final Appropriation	Expenditures	Unexpended Appropriation
Salaries and Wages	\$ 7,778,541	\$ (65,000)	\$ 7,713,541	\$ 7,686,906	\$ 26,635
Operating Expenses	3,174,778	431,000	3,605,778	3,550,138	55,640
Capital Assets	350,606	47,200	397,806	397,749	57
Capital Improvement Off System		265,700	265,700	25,258	240,442
Totals	\$ 11,303,925	\$ 678,900	\$ 11,982,825	\$ 11,660,051	\$ 322,774

Expenditures by Source:					
General Fund	\$ 4,329,092	\$ 265,700	\$ 4,594,792	\$ 4,274,535	\$ 320,257
Special Fund	6,974,833	413,200	7,388,033	7,385,516	2,517
Totals	\$ 11,303,925	\$ 678,900	\$ 11,982,825	\$ 11,660,051	\$ 322,774

Appropriation Adjustments:

Salaries and Wages

\$65,000 was transferred from salaries and wages to operating for expenditures related to contract nursing.

Operating Expenses

- \$116,000 approved by the emergency commission to accept other funds for purchasing medications for pharmacy.
- \$150,000 approved by the emergency commission to accept other funds from increased resident rent to primary care labs, tests, x-rays, and contract nurses.
- \$100,000 approved by the emergency commission to accept other funds for medications, primary care labs, medical tests, x-rays, which were previously paid through Fargo's Veterans Administration hospital, and for utilities and travel expenses.
- \$65,000 transferred from salaries and wages.

Capital Assets

\$47,200 approved by the emergency commission to accept other funds for repairs, replacements, and equipment in home and in commandant's residence.

Capital Improvement Off System

This adjustment is a general fund appropriation pursuant to House Bill 1007, 2007-09 biennium, for life safety improvements and preplanning costs for the new veterans' home.

Internal Control

In our audit for the biennium ended June 30, 2007, we identified the following areas of the North Dakota Veterans' Home internal control as being the highest risk:

Internal Controls Subjected To Testing

- Controls surrounding the processing of revenues.
- Controls surrounding the processing of expenditures.
- Controls effecting the safeguarding of assets.
- Controls relating to compliance with legislative intent.
- Controls surrounding the ConnectND (PeopleSoft) system.
- Controls surrounding the front window receipting system (MDI Technology).

The criteria used to evaluate internal control are published in the publication *Internal Control – Integrated Framework* from the Committee of Sponsoring Organizations (COSO) of the Treadway Commission.

We gained an understanding of internal control surrounding these areas and concluded as to the adequacy of their design. We also tested the operating effectiveness of those controls we considered necessary based on our assessment of audit risk. We concluded that internal control was not adequate noting certain matters involving internal control and its operation that we consider to be significant deficiencies.

Auditors are required to report deficiencies in internal control that are significant within the context of the objectives of the audit. A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect (1) misstatements in financial or performance information, (2) violations of laws and regulations, or (3) impairments of effectiveness or efficiency of operations, on a timely basis. Considering both qualitative and quantitative factors, we identified the following significant deficiencies in internal control. We also noted other matters involving internal control that we have reported to management of the North Dakota Veterans' Home in a management letter dated July 22, 2008.

COMPUTER PROCESSING CONTROLS WEAKNESS

Finding 07-1

Controls surrounding processing of front window financial transactions are not adequate. The software used to account for the activity does not number the transactions. This applies to receipts, expenditures, and adjustments for the clearing account, resident trust accounts, and custodial accounts. For our audit period the system was used to process deposits of over \$5.5 million to the State Treasurer. Proper internal control dictates that activity processed on a computer system should be numbered for accountability. Without proper processing controls, determining completeness of activity is greatly reduced.

Audit Recommendation and Agency Response

Recommendation:

We recommend the North Dakota Veterans' Home update the front window software system to begin numbering transactions, or obtain a system that does.

North Dakota Veterans' Home Response:

Agree. We have submitted numbers in our 2009-2011 budget requesting funding for a new software system that will address these issues.

ACCOUNTS RECEIVABLE SUBSIDIARY

Finding 07-2

The detailed schedule of outstanding skilled care charges did not support the receivables of \$361,965 reported on the June 30, 2007 closing package. We projected that the actual receivable balance may have been \$49,500 higher. This occurred when the Home converted to a new computer system without completely verifying the new beginning balances to the old ending balances. During most of fiscal year 2007 the Veterans Home was using three systems – a manual system, the old computer system, and the new computer system. Basic internal controls require support for accounts receivable to prevent financial statement misstatements.

Audit Recommendation and Agency Response

Recommendation:

We recommend the North Dakota Veterans' Home reconcile their manual system and the old computer system for receivables and update the new computer system to accurately reflect the amount owed.

North Dakota Veterans' Home Response:

Agree. Veteran's Home staff are verifying balances in the manual system and the old system (Dynamics) and updating the new computer system (MDI) to reflect the correct amounts.

PURCHASING CARD SUPPORT

Finding 07-3

Purchase card expenditures were not always properly supported. We noted that two of five items (\$520 out of \$2,839) tested did not have an invoice to support the expenditure. Total purchase card expenditures for the audit period were \$60,899.

OMB's Purchasing Card Manual states to retain the original receipts/invoices for reconciliation purposes and forward, along with the monthly account statement, to the applicable supervisor. It is the cardholder's responsibility to reconcile the monthly account statement with the receipts/invoices. Invoices are necessary to determine whether expenditures are necessary, reasonable, and properly coded.

Audit Recommendation and Agency Response

Recommendation:

We recommend the North Dakota Veterans' Home require, and retain, receipts/invoices for all purchase card transactions.

North Dakota Veterans' Home Response:

Agree. Receipts/invoices will be obtained and matched to statements for all purchasing card transactions.

Compliance With Legislative Intent

In our audit for the biennium ended June 30, 2007, we identified and tested the North Dakota Veterans' Home compliance with legislative intent for the following areas that we determined to be significant and of higher risk of noncompliance:

Legislative Intent Included In Our Audit Scope

- Reviewed its policy of staffing for basic care services, including the number of licensed practical nurses as compared to certified nurse assistants scheduled for each shift, and to present a report to the appropriations committees of the sixtieth legislative assembly during the agency's budget presentation regarding justification for the staffing policy and information on savings that may be realized from changes in the policy. (2005 North Dakota Session Laws chapter 35, section 4).
- Completed the transfer of eight skilled nursing care beds to the Veterans' Home (2003 North Dakota Session Laws chapter 7, section 7).
- Compliance with the establishment of the Administrator's salary by the Governing Board (NDCC 37-18.1-03 (1)).
- Compliance with expense reimbursement requirements for voting committee members (NDCC 37-18.1-04).
- Proper use of the State Treasurer (State Constitution, article X, section 12).
- Compliance with appropriations and related transfers (2005 North Dakota Session Laws, chapter 35).
- Compliance with OMB's Purchasing Procedures Manual.
- Travel-related expenditures are made in accordance with OMB policy and state statute.
- Application of proper statutory rates relating to revenue.
- Proper use of outside bank accounts, petty cash funds, and proper authority for investments outside the Bank of North Dakota.
- Adequate blanket bond coverage of employees (NDCC section 26.1-21-08).
- Compliance with fixed asset requirements including record keeping, surplus property, lease and financing arrangements in budget requests, and lease analysis requirements.
- Compliance with payroll related laws including statutory salaries for applicable elected and appointed positions, and certification of payroll.

The criteria used to evaluate legislative intent are the laws as published in the *North Dakota Century Code* and the *North Dakota Session Laws*.

Government Auditing Standards require auditors to report all instances of fraud and illegal acts unless they are inconsequential within the context of the audit objectives. Further, auditors are required to report significant violations of provisions of contracts or grant agreements, and significant abuse that have occurred or are likely to have occurred.

The results of our tests disclosed two instances of noncompliance that are required to be reported under *Government Auditing Standards*. These findings are described below. Other than these findings, we concluded there was compliance with the legislative intent identified above.

ADMINISTRATOR SALARY INCREASE

Finding 07-4

The administrator's salary increase effective July 1, 2005 was not documented in the governing board's minutes.

NDCC section 37-18.1-03 states the governing board has all ordinary powers required of a governing board, including the power to establish qualifications for and selection of an administrator and to determine the salary paid to the administrator, subject to limitations of legislative appropriation.

Audit Recommendation
and Agency Response

Recommendation:

We recommend the North Dakota Veterans' Home document the salary increases of the administrator in the governing board minutes.

North Dakota Veterans' Home Response:

Agree. Salary increases for the administrator will be documented in the governing board minutes.

Finding 07-05

PROCUREMENT

Proper documentation was not available to support a sole source purchase. We noted that one item (for \$37,890.90) out of 10 examined, contained no support to justify why the item was not bid. We were told the item was unique and could be supplied by only one vendor.

North Dakota Administrative Code, Chapter 4-12-09, provides guidance to follow when making limited competition, noncompetitive, or emergency procurements. Such guidance includes required documentation in the procurement file.

Audit Recommendation
and Agency Response

Recommendation:

We recommend the North Dakota Veterans' Home properly document their noncompetitive purchases.

North Dakota Veterans' Home Response:

Agree. All noncompetitive purchases will have proper documentation.

Management Letter (Informal Recommendations)

July 22, 2008

Mr. Mark B. Johnson, Administrator
North Dakota Veterans Home
Box 673
Lisbon, North Dakota 58054

Dear Mr. Johnson:

We have performed an audit of the North Dakota Veterans' Home for the biennium ended June 30, 2007, and have issued a report thereon. As part of our audit, we gained an understanding of the North Dakota Veterans' Home internal control structure to the extent we considered necessary to achieve our audit objectives. We also performed tests of compliance as described in the same report.

Our audit procedures are designed primarily to enable us to report on our objectives including those related to internal control and compliance with laws and regulations and may not bring to light all weaknesses in systems and procedures or noncompliance with laws and regulations which may exist. We aim, however, to use our knowledge of your organization gained during our work to make comments and suggestions which we hope will be useful to you.

In connection with the audit, gaining an understanding of the internal control structure, and tests of compliance with laws and regulations referred to above, we noted certain conditions we did not consider reportable within the context of your audit report. These conditions relate to areas of general business practice or control issues that have no significant bearing on the administration of federal funds. We do, however, want to present our recommendations to you for your consideration and whatever follow-up action you consider appropriate. During the next audit we will determine if these recommendations have been implemented, and if not, we will reconsider their status.

The following presents our informal recommendation.

CODING OF TRAVEL EXPENDITURES

Informal Recommendation 07-1:

During our test of travel expenses, we noted that one item (for \$142.50) out of 10 was not coded to the proper department. The item was coded to plant operations instead of social services.

We recommend the North Dakota Veterans Home properly code expenditures to the correct department.

North Dakota Veterans Home Response:

Agree. Expenditures will be properly coded to the correct department.

I encourage you to call me (701) 239-7289 if you have any questions about the implementation of recommendations included in your audit report or this letter.

Sincerely,

John Grettum, CPA
Audit Manager